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SUBJECT: SPANISH DEPUTY MINISTER OF FINANCE COMMITTED TO ECONOMIC REFORM AGENDA

1. (SBU) Summary. Over lunch with the DCM and Economic Counselor May 3, Secretary of State for Budget and Finance Miguel Angel Fernandez Ordonez expressed his strong commitment to continued fiscal restraint and pushing forward Spain's economic reform agenda to spur competitiveness and enhance Spanish productivity. He strongly criticized the previous Aznar government's opacity in handling domestic budget and other economic policy issues, promising transparency would be the leitmotif for Pedro Solbes as Vice President and Minister of Economy and Finance. Fernandez Ordonez voiced admiration for the transparency of the U.S. budget process and publication of economic statistics and expressed his eagerness to learn more about IRS, OMB and Treasury practices which could be transferable to the Spanish context. Despite his enthusiasm, we believe Fernandez Ordonez will face a difficult time maintaining budget discipline as recently appointed ministers call for new expensive measures on an almost daily basis. He will need to set the tone early and firmly if he is to succeed in maintaining fiscal discipline in the new government. End Summary.

Budget Policy -- A Delicate Balancing Act

2. (SBU) We met for lunch May 3 with the new number two at the Ministry of Economy and Finance, Miguel Angel Fernandez Ordonez. A long time admirer of the US and veteran of previous Socialist administrations, Fernandez Ordonez stressed his commitment to pursuing sound fiscal policy as the senior Ministry official responsible for developing budget and tax policy. Fernandez Ordonez credited the former Aznar administration with selling the importance of sound fiscal policy to the Spanish electorate, which he believed would not stand for loose budget deficits outside the framework of EU rules.

3. (SBU) To his dismay, however, Fernandez Ordonez said he was discovering many "under the table" budget deals had been struck by the former government, particularly with the autonomous regions. The deals provided him with less flexibility to manage budget policy than he had anticipated. The prior government had been very good at lowering taxes but not very good about decreasing expenditures. In response to our questions about how he planned to finance the many potentially expensive campaign commitments while maintaining budget discipline, Fernandez Ordonez said some expenditure cuts would have to be made to finance the new programs -- and not all of the new programs would be implemented immediately. He denied the government had plans to cut defence spending by four billion euros to fund these programs as suggested by some media reports. The Deputy Minister said he will propose that the government privatize as soon as possible the publicly-owned and heavily indebted Spanish Radio and Television Corporation (RTVE) as a source of revenue for these projects. He also hoped to cut coal subsidies and introduce more financial discipline into the national railroad (RENFE) high speed train plans. Fernandez Ordonez cited housing, more funding for R&D and an increase in university scholarships as the programs likely to be funded first. The first was a key election commitment and the latter two would help improve Spain's lagging productivity.

4. (SBU) Fernandez Ordonez said he was committed to transparency in the conduct of budget policy. Toward this end, the Zapatero government planned to establish a budget office in Parliament styled on the Congressional Budget Office. A campaign pledge, this office would help members of parliament understand the budgets on which they voted, improving the credibility of the entire process.

Reform: Full Speed Ahead

5. (SBU) Sharply critical of the Aznar government's commitment to economic reform during its second term in office, Fernandez Ordonez claimed the former government's philosophy was "believe what I say not what I do." For example, liberalization of the electricity sector was more words than deeds as two companies continued to dominate the sector. Privatization became a way to place friends -- witness Cesar Alierta's placement at Telefonica -- rather than the introduction of true competition. In hindsight, the opposition should have demanded that the Aznar government set up independent regulatory frameworks before privatization of

these companies. In the latter years of the Aznar government, there was no attempt to reform social security, pensions or labor practices.

16. (SBU) Fernandez Ordonez said the Zapatero government was committed to pushing ahead with these reforms. Improving competitiveness and productivity would be essential to continued strong levels of economic growth. In the past, Spain had always improved its competitiveness by devaluation. He attributed the reluctance of small and medium-sized businesses (SMEs) to invest in new technology to improve competitiveness to this pattern. Experience showed they could still sell abroad without such investments. As a participating country in the euro, this option was no longer possible. The only answer was reform.

17. (SBU) Fernandez Ordonez seemed confident that the Socialist government found itself in a better position to introduce more flexibility in the Spanish labor market than its predecessor. He pointed to comments by the head of one of Spain's main unions over the weekend, in which the labor leader listed his demands of the new government but cautioned that the government couldn't possibly grant all the union's wishes without hurting the economy. In response to our question about a PSOE government's potential squeamishness about increased unemployment that might come in the wake of these reforms, Fernandez Ordonez appeared confident the government would weather any initial deterioration in the unemployment figures. He compared Spain favorably to Germany or France in that Spaniards still had a drive to change and understood further changes would be necessary to keep the economy growing.

Willing to Learn From US

18. (U) Fernandez Ordonez said in his previous jobs he tried to learn from the US and apply those lessons in Spain. He cited his close relations with the Federal Trade Commission when he chaired the Spanish competition tribunal as one example. Fernandez Ordonez said he hoped to travel to the US within a few months and meet with his counterparts at Treasury, the IRS and elsewhere. He offered that if we identified any U.S. budget or tax practices which we thought could improve transparency and efficiency in Spain we should feel free to provide him with information.

Comment

19. (SBU) Despite his optimism and passion when discussing sound macroeconomic policies, we believe Fernandez Ordonez faces a tough road ahead. In the few short weeks the Zapatero government has been in power, many new ministers have announced potentially expensive and clearly unvetted policy initiatives -- such as a cut in the VAT for books and movies or increased subsidies to mothers with young children -- only to walk these statements back a few days later. We understand that Solbes will be delegating heavily to Fernandez Ordonez, whom many have already picked to replace Solbes (who is rumored to be in poor health and only to have committed to the job for two years) if he succeeds in his bold agenda of fiscal discipline and further economic reform. To do so, Fernandez Ordonez will need to be aggressive in establishing his authority and have the clear backing of President Zapatero's office.

ARGYROS